



DEPARTMENT OF  
**FINANCE**

ARNOLD SCHWARZENEGGER, GOVERNOR

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February 3, 2009

Mark B. Horton, M.D., M.S.P.H., Director  
California Department of Public Health  
1615 Capitol Avenue, MS 0500  
P.O. Box 997377  
Sacramento, CA 95899-7377

Dear Dr. Horton:

**Final Report—California Department of Public Health, Safe Drinking Water State Revolving Fund, Financial Audit**

The Department of Finance, Office of State Audits and Evaluations, has completed its financial audit of the California Department of Public Health (Department), Safe Drinking Water State Revolving Fund for the fiscal year ended June 30, 2008.

The enclosed report is for your information and use. The Department's response to the report finding is incorporated into this final report. The Department agreed with our observation and we appreciate its willingness to implement corrective actions. The observation in our report is intended to assist management in improving the effectiveness and efficiency of its operations.

In accordance with Finance's policy of increased transparency, this report will be placed on our website. A separate report will be issued on the Department's compliance with federal requirements.

We appreciate the assistance and cooperation of the Department. If you have any questions regarding this report, please contact Richard R. Sierra, Manager, or James Kong, Supervisor, at (916) 322-2985.

Sincerely,

*Original signed by:*

David Botelho, Chief  
Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Dr. Bonita Sorensen, Chief Deputy Director of Policy and Programs, California  
Department of Public Health  
Mr. Rufus Howell, Division Chief, Drinking Water and Environmental Management,  
California Department of Public Health  
Mr. Russell Huck, Chief, Infrastructure Funding Administration Section, California  
Department of Public Health  
Ms. Mary Cody, Audit Coordinator, California Department of Public Health  
Ms. Julianne Talbot, CPA, Division of Accounting and Reporting, State Controller's Office

A F INANCIAL A UDIT

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California Department of Public Health  
Safe Drinking Water State Revolving Fund  
For the Fiscal Year Ended  
June 30, 2008

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

**MEMBERS OF THE AUDIT TEAM:**

Richard R. Sierra, CPA, CGFM  
Manager

James Kong  
Supervisor

**Staff**

Alma Ramirez, CPA  
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This report is also available on our website at <http://www.dof.ca.gov>.

You can contact our office at:

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## INDEPENDENT AUDITOR'S REPORT

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Mark B. Horton, M.D., M.S.P.H., Director  
California Department of Public Health  
1615 Capitol Avenue, MS 0500  
P.O. Box 997377  
Sacramento, CA 95899-7377

We have audited the accompanying Statement of Net Assets, Statement of Revenue, Expenses, and Changes in Net Assets, and Statement of Cash Flows of the Safe Drinking Water State Revolving Fund (Fund) as of and for the year ended June 30, 2008. These financial statements are the responsibility of the California Department of Public Health's (Department) management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management. We believe that our audit provides a reasonable basis for our opinion.

In connection with our audit, there are certain disclosures required by *Government Auditing Standards*. Finance is not independent of the audited entity, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

As discussed in Note 1, Definition of Reporting Entity, the financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the financial reporting entity of the Department that is attributable to the transactions of the Fund. They do not purport to, and do not present the financial position of the State of California as of June 30, 2008, or the changes in its financial position or its cash flows.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2008, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider the deficiency described in the *Finding and Recommendations* section of this report to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency referred to above to be a material weakness.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of Department management, those charged with governance, and state control agencies, and is not intended to be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*Original signed by:*

David Botelho, CPA  
Chief, Office of State Audits and Evaluations  
(916) 322-2985

January 30, 2009



# STATEMENT OF NET ASSETS

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**California Department of Public Health  
Safe Drinking Water State Revolving Fund  
June 30, 2008**

**ASSETS**

Current Assets

Cash and pooled investments	\$ 95,446,666
Receivables	
Loan interest	2,337,270
Investment interest	602,882
Due from other funds	4,584,579
Due from federal trust fund	17,972,887
Current portion of loans receivable	<u>15,664,083</u>
Total Current Assets	<u>136,608,367</u>

Noncurrent Assets

Loans receivable	<u>484,241,126</u>
Total Noncurrent Assets	<u>484,241,126</u>

Total Assets	<u>620,849,493</u>
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**LIABILITIES**

Current Liabilities

Accounts payable	3,625,937
Due to other funds	1,332,784
Due to other governments	<u>23,579,322</u>
Total Current Liabilities	28,538,043

Noncurrent Liabilities

Compensated absences payable	<u>575,697</u>
Total Noncurrent Liabilities	<u>575,697</u>

Total Liabilities	<u>29,113,740</u>
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**NET ASSETS**

Restricted	<u>591,735,753</u>
Total Net Assets	<u>\$ 591,735,753</u>

The accompanying notes are an integral part of this statement.

# STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS

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**California Department of Public Health  
Safe Drinking Water State Revolving Fund  
For the Year Ended June 30, 2008**

<b>Operating Revenue</b>	
Charges for loan interest	<u>\$ 9,130,158</u>
Total operating revenue	9,130,158
<b>Operating Expenses</b>	
Salaries and benefits	5,064,804
Other expenses	5,368,542
Grant awards	<u>3,713,315</u>
Total operating expenses	<u>14,146,661</u>
<b>Income (loss) from operations</b>	(5,016,503)
<b>Nonoperating Revenue</b>	
Investment earnings	<u>3,137,715</u>
Total nonoperating revenue	<u>3,137,715</u>
<b>Income (loss) before transfers</b>	(1,878,788)
<b>Transfers-in</b>	
EPA capitalization grant	50,301,168
State match	<u>21,558,674</u>
Total transfers-in	<u>71,859,842</u>
<b>Change in net assets</b>	69,981,054
<b>Net assets—beginning</b>	<u>521,754,699</u>
<b>Net assets—ending</b>	<u>\$591,735,753</u>

The accompanying notes are an integral part of this statement.

# STATEMENT OF CASH FLOWS

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## California Department of Public Health Safe Drinking Water State Revolving Fund For the Year Ended June 30, 2008

### CASH FLOW FROM OPERATING ACTIVITIES

Cash received from interest on loans	\$ 9,653,690
Loans disbursed	(58,051,550)
Principal received on loans receivable	13,713,117
Cash paid to employees and vendors	(8,637,656)
Cash paid for grant disbursements	<u>(1,909,665)</u>
Net cash flows from operating activities	(45,232,064)

### CASH FLOW FROM INVESTING ACTIVITIES

Interest received from investments	<u>3,272,995</u>
Net cash flows from investing activities	3,272,995

### CASH FLOW FROM NONCAPITAL FINANCING ACTIVITIES

Transfers from the Environmental Protection Agency	49,146,272
Transfers from the State of California	<u>20,761,911</u>
Net cash flows from noncapital financing activities	69,908,183

Net increase in cash and cash equivalents	27,949,114
Cash and cash equivalents—July 1, 2007	<u>67,497,552</u>
Cash and cash equivalents—June 30, 2008	<u>\$ 95,446,666</u>

### Reconciliation of operating income (loss) to net cash flows provided (used) from operating activities

Operating income (loss)	\$ (5,016,503)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activity:	
Decrease in interest receivable	138,700
(Increase) in loans receivable	(47,265,778)
(Increase) in due from federal trust fund	(1,208,254)
Decrease in due from other funds	15,378,528
(Decrease) in accounts payable	(31,711,596)
Increase in due to other funds	641,650
Increase in due to other governments	23,579,322
Increase in compensated absences payable	<u>231,867</u>
Total adjustments	<u>(40,215,561)</u>
Net cash flows from operating activities	<u>\$ (45,232,064)</u>

The accompanying notes are an integral part of this statement.

# NOTES TO THE FINANCIAL STATEMENTS

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## California Department of Public Health Safe Drinking Water State Revolving Fund Year Ended June 30, 2008

### NOTE 1      **Definition of Reporting Entity**

Effective July 1, 2007, the California Department of Health Services was divided into two separate departments: the California Department of Health Care Services and the California Department of Public Health. Pursuant to Chapter 241, Statutes of 2006 (SB 162), specific programs and public health responsibilities were transferred from the former California Department of Health Services to the newly established California Department of Public Health. The Safe Drinking Water State Revolving Fund (Fund) is now administered by the California Department of Public Health (Department).

The Fund was created pursuant to Health and Safety (HSC) Code Section 116760.30, and is continuously appropriated without regard to fiscal year. The Fund is capitalized by the U.S. Environmental Protection Agency (EPA) by a series of federal grants. As a condition for receiving the federal grant, the Department is required to provide an additional 20 percent of matching funds. The Department uses the Fund primarily to make loans to public water systems for financing the cost of infrastructure needed to achieve or to maintain compliance with the Safe Drinking Water Act requirements and to protect public health.

The activities of the Fund are included in the State of California's *Comprehensive Annual Financial Report*. The Fund includes the federal loan fund, two state match loan funds, and five set-aside funds. The set-aside funds are the:

(1) Administration Account, (2) Water System Reliability Account, (3) Source Protection Account, (4) Small System Technical Assistance Account, and (5) Public Water System, Safe Drinking Water Revolving Fund.

The Public Water System, Safe Drinking Water Revolving Fund is a set-aside fund that was created during fiscal year 2006-07 to pay for expenses that provide public water system oversight activities to support the Fund's loan and grant program. The establishment of the separate set-aside funds to account for the costs related to the administration of the Fund is consistent with federal guidelines. The loan and set-aside funds are combined to form the Fund's financial statements.

## NOTE 2      **Summary of Significant Accounting Policies**

### *Fund Accounting*

The Fund is classified as an enterprise fund. Enterprise funds account for goods or services provided to the general public on a continuing basis when: (1) the department intends that all or most of the cost involved is to be financed by user charges, or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes. The Fund applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, pursuant to GASB Statement No. 20, as well as all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements. For purposes of the Statement of Cash Flows, all cash and pooled investments, as discussed in Note 4, are considered to be cash equivalents.

### *Measurement Focus and Basis of Accounting*

The Fund is accounted for on the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded at the time the liabilities are incurred.

### *Principal Forgiveness Recognition*

The Department may authorize principal forgiveness on loans disbursed to disadvantaged communities. Principal forgiveness is recognized as an expense as loan disbursements are made. As of June 30, 2008, the Department did not report principal forgiveness on any of the Fund's loans.

### *Compensated Absences*

State employees are eligible to accrue annual leave, vacation, and sick leave. Annual leave accrues at a rate of 11 to 20 hours per month, with an annual accrual cap of 640 hours. Vacation accrues at a rate of 7 to 16 hours per month, with an annual accrual cap of up to 640 hours. Accrued annual leave and vacation are paid out upon termination while sick leave is not. As of June 30, 2008, the Fund's compensated absences totaled \$575,697.

### *Restatement of Beginning Net Assets*

In the prior year, an operating transfer accrual for encumbrances in the amount of \$1,891,763 was not properly reversed from the *Due from federal trust fund* account balance. An adjustment was made in the current year to correct the effect of this error, which resulted in the adjustment of the beginning net asset balance from \$523,646,462 to \$521,754,699.

**NOTE 3 Capitalization Grants**

The Fund is financed by annual grants from the U.S. Environmental Protection Agency (EPA) and a state match equal to 20 percent of the federal award.

Of the amount awarded by EPA, the Department has designated \$84.7 million for administrative expenses, program management, small system technical assistance, local assistance, and other state program expenses (collectively known as set-asides), and disbursed \$461.1 million for loans. Set-asides are accounted for in other funds.

The grants awarded, amounts drawn on each grant, and the loan balances available for active grants, as of June 30, 2008, are presented below:

Grant Year	Capitalization Grant Award	Award Available for Set-Aside	Award Available for Loans	Award Drawn for Loans	Available for Loans as of June 30, 2008
1997	\$ 75,682,600	\$ 10,048,176	\$ 65,634,424	\$ 65,634,424	\$ -
1998	77,108,200	4,934,925	72,173,275	72,173,275	-
1999	80,816,700	5,172,269	75,644,431	75,644,431	-
2000	83,993,100	2,000,000	81,993,100	81,993,100	-
2001	84,340,000	7,060,400	77,279,600	77,279,600	-
2002	82,392,347	6,879,101	75,513,246	75,513,246	-
2003	81,966,200	11,016,282	70,949,918	10,608,863	60,341,055
2004	84,957,600	16,601,008	68,356,592	2,263,333	66,093,259
2005	84,847,500	12,248,614	72,598,886	-	72,598,886
2006	67,123,678	8,700,249	58,423,429	-	58,423,429

In the past, the state's matching contributions were provided through General Fund appropriations. Under federal guidelines, the state is not required to provide the match until the date it receives federal funds for a particular grant year. Since the Fund's inception, the state has contributed match totaling \$99.6 million.

**NOTE 4 Cash and Pooled Investments**

Cash in excess of current needs is deposited in the state's centralized treasury system, which combines the balances of state agencies into a single bank account to simplify cash management. The Surplus Money Investment Fund (SMIF) is managed by the Pooled Money Investment Board (PMIB). State statutes, bond resolutions, and investment policy resolutions allow the PMIB to invest in government securities, certificates of deposit, banker's acceptances, commercial paper, corporate bonds, mortgage loans and notes, other debt securities, repurchase agreements, equity securities, real estate, investment agreements, mutual funds, and other investments.

The reported amount represents an equity share in the balance of the investment pool. Since there are no individually owned investments, the deposit in SMIF is not reported by type of investment.

## NOTE 5      Loans Receivable

The Fund makes loans to qualified local and private entities at interest rates ranging between 0 percent and 50 percent of the average rate paid by the state on general obligation bonds. Loans must be repaid within 20 years after completion of the project (30 years for financially disadvantaged communities). Recipients make semiannual or, in some cases, annual payments generally starting twelve months after project completion.

The Department disburses the loan proceeds on a cost reimbursement basis. As entities spend money on projects financed by the Fund and request reimbursement, the Department releases the loan proceeds. Interest accrues on all loan disbursements as of the date each disbursement is made.

There is no allowance for uncollectible accounts, as all repayments are current, and management believes all loans will be repaid according to the loan terms. There have been no loan defaults in the program since its inception.

The following schedule of loans receivable activity for the year ended June 30, 2008 lists each water system's outstanding loan balance. Included in the *Active Loans* category are water systems that have both fully disbursed and active loans outstanding.

Entity	Outstanding Loan Balances June 30, 2007	Loans Issued as of June 30, 2008	Principal Payments as of June 30, 2008	Outstanding Loan Balances June 30, 2008
<b>Fully Disbursed Loans</b>				
Anaheim, City of	\$14,048,282	-	\$(798,038)	\$13,250,244
Angels, City of	1,191,489	-	(74,468)	1,117,021
Asoleado Mutual Water Company	34,580	-	(5,901)	28,679
Benicia, City of	11,647,575	69,173	(463,113)	11,253,635
Biola Community Service District	177,000	-	(13,275)	163,725
Blythe, City of	9,807,160	-	(392,286)	9,414,874
Brawley, City of	14,068,882	-	(705,151)	13,363,731
California Water Service Co.	-	494,276	-	494,276
Colusa, County of	171,720	-	-	171,720
Capell Valley Estates (Joe Family)	648,000	-	(25,293)	622,707
Crescent City, City of	5,950,000	-	(525,000)	5,425,000
Del Rey Community Svc District	166,634	-	(8,619)	158,015
Dunsmuir, City of	53,010	-	(2,790)	50,220
Dutch Flat Mutual Water Company	185,598	-	(8,269)	177,329
East Bay Municipal Utility District	1,879,516	-	(46,894)	1,832,622
East Valley Water District	158,909	-	(6,762)	152,147
Eastern Municipal Water District	41,967,897	130,491	-	42,098,388
Escondido, City of	1,802,175	-	(86,165)	1,716,010
Fort Bragg, City of	2,034,456	-	(53,538)	1,980,918
Garberville Sanitary District	-	100,000	-	100,000
Grenada Sanitary District	540,833	-	(19,667)	521,166
Grizzly Flats Community Services Dept.	223,691	-	(10,443)	213,248

Entity	Outstanding Loan Balances June 30, 2007	Loans Issued as of June 30, 2008	Principal Payments as of June 30, 2008	Outstanding Loan Balances June 30, 2008
Hillview Water Co., Inc.	3,381,616	327,777	-	3,709,393
Humboldt Bay Municipal Water District	9,031,059	-	(273,668)	8,757,391
Imperial County	71,415	-	(3,577)	67,838
Imperial County Parks	139,450	-	(3,670)	135,780
Indian Valley Community Services District	106,744	-	(4,543)	102,201
Ivanhoe Public Utilities District	1,456,891	-	(112,069)	1,344,822
Kings, County of	991,251	-	(33,042)	958,209
Konocti Bay (formerly Ford's Acres)	153,607	-	(10,908)	142,699
Lake Combie Mobile Home Village	48,352	-	(2,312)	46,040
Metropolitan Water District	17,987,933	-	(838,891)	17,149,042
Rio Dell, City of	2,720,000	-	-	2,720,000
Richardson Beardsley Park, Inc.	50,115	-	(2,436)	47,679
River Pines Public Utility District	190,000	-	(9,500)	180,500
Rural North Vacaville Water District	7,354,029	-	(371,828)	6,982,201
San Buenaventura, City of	20,000,000	-	(392,910)	19,607,090
San Diego, City of	20,257,021	-	(872,269)	19,384,752
San Luis Obispo CFCD	286,351	-	(13,691)	272,660
Santa Barbara, City of	36,107,034	-	(1,503,615)	34,603,419
Santiago County Water District	1,221,924	-	(53,572)	1,168,352
Santiago Associates (Paradise Ranch)	617,713	170,641	-	788,354
Sereno del Mar Water Co.	198,678	-	(11,056)	187,622
Serrano Water District	2,361,140	-	(236,914)	2,124,226
Shady Glen Enterprises	136,878	-	(5,438)	131,440
Sierra Lakes County Water District	1,203,857	-	(53,637)	1,150,220
Sierra Mobile Home Park	51,721	-	(4,433)	47,288
Southern Humboldt Unified School Dist	23,608	-	(1,431)	22,177
Spanish Flat Water District	272,513	-	-	272,513
Stinson Beach County Water Dist	378,579	-	(17,056)	361,523
Strathmore Public Utility District	451,500	136,010	(15,050)	572,460
Tracy, City of	18,249,848	1,750,152	(394,960)	19,605,040
Truckee Donner Public Utility Dist	12,227,122	-	(781,175)	11,445,947
Vallejo, City of	4,853,099	-	(313,024)	4,540,075
Westmorland, City of	586,803	-	(33,532)	553,271
Yolo County Airport	239,428	-	(10,138)	229,290
Yuba City, City of	641,135	-	(36,636)	604,499
<b>Fully Disbursed Loans Totals</b>	<b>270,805,821</b>	<b>3,178,520</b>	<b>(9,662,653)</b>	<b>264,321,688</b>
<b>Active Loans</b>				
Bella Vista Water District	9,717,184	120,998	-	9,838,182
Carpinteria Valley Water District	16,481,479	657,844	(317,746)	16,821,577
Contra Costa Water District	19,460,363	-	(995,300)	18,465,063
Dinuba, City of	2,524,567	3,643,115	-	6,167,682
El Dorado Irrigation District	16,418,713	-	(583,946)	15,834,767
Fruitridge Vista Water Co.	2,840,183	160,931	(163,625)	2,837,489
Kerman, City of	2,673,126	626,873	-	3,299,999
Kern County	-	991,941	-	991,941
Lake Alpine Water Co.	2,201,732	211,629	-	2,413,361



Entity	Outstanding Loan Balances June 30, 2007	Loans Issued as of June 30, 2008	Principal Payments as of June 30, 2008	Outstanding Loan Balances June 30, 2008
Los Angeles, City of	70,959,255	-	(757,275)	70,201,980
Meadow Vista Co Water District	59,367	1,851,233	(14,290)	1,896,310
Montecito Water District	8,341,026	657,844	-	8,998,870
North Marin Water District	15,045,844	59,475	-	15,105,319
Redlands, City of	5,980,364	-	(245,204)	5,735,160
San Jose Water Company	1,887,090	1,069,265	(82,197)	2,874,158
San Luis Obispo Co Flood Control & Wtr Conservation District	18,801,753	5,492,679	-	24,294,432
Santa Clara Valley Water District	5,575,741	774,258	-	6,349,999
Sequoia Crest Water Co., Inc.	120,949	-	-	120,949
Solano Irrigation District	3,067,116	-	(213,553)	2,853,563
Sonoma County Water District	11,401,362	3,712,865	-	15,114,227
Spring Valley Heights Assoc.	-	1,714,252	-	1,714,252
Terra Bella Irrigation District	965,245	93,125	(66,041)	992,329
Tuolumne Utilities District	42,888	-	(2,451)	40,437
Union Public Utility District	2,073,288	223,163	-	2,296,451
Willow Creek CSD	-	470,884	-	470,884
<b>Active Loans Totals</b>	<b>216,638,635</b>	<b>22,532,374</b>	<b>(3,441,628)</b>	<b>235,729,381</b>
<b>Totals - All Loans</b>	<b>\$487,444,456</b>	<b>\$25,710,894</b>	<b>\$(13,104,281)</b>	<b>\$500,051,069</b>

Loans mature at various intervals through June 1, 2038. The scheduled principal and interest payments on loans for fully disbursed projects maturing in the next four years and every five years thereafter are as follows:

	INTEREST	PRINCIPAL	TOTAL
FY 2008	\$ 5,333,463	\$ 15,664,083	\$ 20,997,546
FY 2009	5,075,688	15,926,591	21,002,279
FY 2010	4,806,568	16,195,712	21,002,280
FY 2011	4,530,766	16,455,821	20,986,587
FY 2012 - FY 2016	18,275,575	86,331,868	104,607,443
FY 2017 - FY 2021	10,401,186	91,532,233	101,933,419
FY 2022 - FY 2026	2,810,222	62,416,978	65,227,200
FY 2027 - FY 2031	32,846	6,065,802	6,098,648
FY 2032 - FY 2038	-	1,296,796	1,296,796
<b>TOTALS</b>	<b>\$51,266,314</b>	<b>\$311,885,884</b>	<b>\$363,152,198</b>

The amortization schedules for the active projects may change upon completion of the project when the final loan balance will be determined.

**NOTE 6      Penalties and Fees**

The Fund assesses a penalty of one-tenth of one percent (0.10 percent) per day from the repayment due date on the amount due on loan repayments past due. However, for the fiscal year ended June 30, 2008, the Department elected not to impose late payment penalties. Changes to workload priorities associated with the Department's reorganization delayed the preparation of loan recipient invoices, and late payment penalties were waived as a result. In prior years late payment penalties were insignificant.

**NOTE 7      Retirement Plan**

*Plan Description*

The State is a member of the California Public Employees' Retirement System (CalPERS), which provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries.

CalPERS is a defined benefit contributory retirement plan. Retirement contributions by employees are set by statute as a percentage of payroll (Tier I employees), or are zero (Tier II employees). Retirement contributions are actuarially determined under a program where total contributions plus CalPERS' investment earnings will provide the necessary funds to pay retirement benefits when incurred. The employer contributions are included in the cost of personal services.

The Fund is included in the State Miscellaneous Category within CalPERS. CalPERS functions as an investment and administrative agent for participating public agencies with the State of California, including the Fund. All risks and costs are shared proportionately by participating state agencies. For further information, refer to the *State of California Comprehensive Annual Financial Report*, and to the *CalPERS Comprehensive Annual Financial Report*.

**NOTE 8      Subsequent Events**

On September 18, 2008, the EPA awarded the Department a \$67.1 million capitalization grant for the period October 1, 2008 through June 30, 2014. The grant consists of \$58.1 million to the loan fund and \$9 million to the set-aside funds. In addition, the state's 20 percent match of \$18.4 million will be added to the loan fund. Allowable project costs under this capitalization grant total \$85.5 million.

## FINDING AND RECOMMENDATIONS

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During our audit of the California Department of Public Health's (Department) Safe Drinking Water State Revolving Fund (Fund), we noted certain matters concerning the Department's accounting and administrative controls. We consider the following finding to be a material weakness. If left uncorrected, this weakness could compromise the accuracy of the Fund's financial statements.

### **FINDING                      Internal Controls over Financial Reporting Require Improvement**

**Condition:**                      The Department needs to improve its internal controls over financial reporting. The existing controls failed to detect, prevent, and correct material misstatements in the Fund's financial statements. Specifically, the following weaknesses were noted:

- A. Although the Department has made progress in its financial accounting and reporting, it did not accurately prepare the year-end adjustments necessary for the presentation of the Fund's financial statements in accordance with Generally Accepted Accounting Principles (GAAP). For fiscal year 2007-08, several material entries were either incorrect or not prepared. The Department relies on its independent auditor to prepare the GAAP adjustments to the following general ledger accounts: expenditures, operating transfers-in, due to/from others, accounts payable, compensated absences payable, and net assets.
- B. Impairing the Department's ability to prepare GAAP statements is the lack of monthly and annual reconciliations of subsidiary ledgers with general ledger accounts. The outstanding loan balances, loan disbursements, federal transfers, and state match expenditures were unreconciled with the general ledger for all months, and appropriation balances were unreconciled with the State Controller for September 2007 and October 2007. Such reconciliations are critical and prerequisite to the preparation of accurate financial statements.
- C. The Department incorrectly recorded \$22 million of fiscal year 2007-08 expenditures as 2008-09 expenditures. A review of year-end encumbrances and obligations would have identified the error.

Criteria: Sections 13401 and 13403 of the California Government Code, and Section 20050 of the State Administrative Manual (SAM) require each state agency to maintain effective systems of internal accounting and administrative controls. Such controls include procedures that ensure the preparation of accurate and reliable financial reports.

SAM Section 7920 states that each agency is responsible for completing any reconciliation necessary to safeguard the state's assets and ensure reliable financial data. Section 7921 requires agencies to reconcile their accounts with like accounts maintained by the State Controller's Office, and Section 7901 states that all reconciliations will be prepared monthly within 30 days of the preceding month.

SAM Section 10608 states that all encumbrances unliquidated as of June 30 will be reviewed to determine whether they are valid obligations and expenditures of the year then ended.

- Recommendations:
1. Prepare the year-end adjustments necessary for the presentation of the Fund's financial statements in accordance with GAAP. Provide training for the Department's accounting staff to enable them to prepare the adjustments.
  2. Reconcile all subsidiary ledgers with the general ledger, and all accounts with the State Controller monthly.
  3. Review outstanding encumbrances at June 30 for validity and proper classification.





MARK B HORTON, MD, MSPH  
Director

State of California—Health and Human Services Agency  
California Department of Public Health



ARNOLD SCHWARZENEGGER  
Governor

JAN 13 2009

David Botelho, Chief  
Department of Finance  
Office of Audits and Evaluations  
300 Capitol Mall, Suite 801  
Sacramento, CA 95814

Dear Mr. Botelho:

The California Department of Public Health (CDPH) has prepared its response to the California Department of Finance draft report entitled, "Draft Audit Report: California Department of Public Health, Safe Drinking Water State Revolving Fund, Financial Audit." The CDPH appreciates the opportunity to provide the Department of Finance with responses to the draft report.

Please contact Rufus Howell, Deputy Director, Center for Environmental Health, at (916) 445-0275, should you have any questions.

Sincerely,

Original signed by:

~~Mark~~ Mark B Horton, MD, MSPH  
Director

Enclosure

cc: Rufus Howell  
Acting Deputy Director  
Center for Environmental Health  
MS 0511  
P.O. Box 997377  
Sacramento, CA 95899-7377

FINDING

Internal Controls over Financial Reporting Require Improvement

- A. Although the Department has made progress in its financial accounting and reporting, it did not accurately prepare the year-end adjustments necessary for the presentation of the Fund's financial statements in accordance with Generally Accepted Accounting Principles (GAAP). For fiscal year 2007-08, several material entries were either incorrect or not prepared. The Department relies on its independent auditor to prepare the GAAP adjustments to the following general ledger accounts: expenditures, operating transfers-in, due to/from others, accounts payable, compensated absences payable, and net assets.

RESPONSE:

CDPH concurs with this finding. A review of the adjustments with DOF for fiscal year 2007/ 08 has acted as a training tool and will assist the Accounting staff in preparing next years GAAP adjustments correctly.

- B. Impairing the Department's ability to prepare GAAP statements is the lack of monthly and annual reconciliations of subsidiary ledgers with general ledger accounts. The outstanding loan balances, loan disbursements, federal transfers, and state match expenditures were unreconciled with the general ledger for all months, and appropriation balances were unreconciled with the State Controller for September and October 2007. Such reconciliations are critical and prerequisite to the preparation of accurate financial statements.

RESPONSE:

CDPH concurs that the reconciliations are of a critical nature and they should be reconciled on a monthly basis. The Accounting staff will make every reasonable effort to maintain a monthly reconciliation of the funds as well as the reconciliation of the Contract Ledger Balances to the General Ledger accounts. To ensure reconciliations are completed timely, CDPH will shift workload and train staff effective January 2009.

- C. The Department incorrectly recorded \$23 million of fiscal year 2007-08 expenditures as 2008-09 expenditures. A review of year-end encumbrances and obligations would have identified the error.

RESPONSE:

CDPH concurs with this finding. Accounting will review invoices processed during the first month of the new fiscal year so we can make the appropriate GAAP adjustments. We also will work with Program to assure that we have accrued via the GAAP adjustments all of the invoices that have been approved for payment before June 30, 2008.